

Memorandum

To : Mr. Richard C. Johnson, Deputy Director
Property Taxes Department

Date: February 17, 2000

From : Timothy W. Boyer
Chief Counsel

Subject : *Duties of a Managing General Partner under Subdivision (g)(1) of Section 214*

You have requested our opinion as to what management duties are required for a nonprofit corporation to qualify as the “managing general partner” of a limited partnership within the meaning of subdivision (g)(1) of Section 214 of the Revenue and Taxation Code.¹ In this memo, we respond to your request and address three separate aspects of this issue. First, we set forth the applicable law and discuss what are sufficient duties to meet the statutory requirements. Second, we identify common drafting problems encountered in limited partnership agreements which we have found do not provide the nonprofit managing general partner with sufficient management duties. Third, we attach examples of provisions which we have found meet the requirements of the law.

I. LAW AND ANALYSIS

A. Neither Section 214 nor Case Law Provides a Definition of Managing General Partner

Section 214, subd. (g)(1) provides exemption from property taxes for property used to provide low-income housing and related facilities owned and operated by “limited partnerships in which the managing general partner is an eligible nonprofit corporation.” The statute neither defines the term “managing general partner” nor specifies the management duties and responsibilities that would be required of a managing general. Further, there are no court cases that interpret this statutory provision.

Thus, the staff of the Board has no specific statutory or case law to guide them in performing their duties under section 254.5. That section requires the Board to review all applications for the Welfare Exemption and accompanying documents submitted in support of a claim for exemption, authorizes the Board to institute an independent audit or verification that the operations of the owner and operator meet the requirements of the law, and requires the Board to make a finding as to the eligibility of each applicant and the applicant’s property.

B. California Partnership Law Provides Guidance Regarding the Authority of a General Partner to Manage the Business of the Limited Partnership

¹ All references are to the Revenue and Taxation Code unless otherwise indicated.

Since the Revenue and Taxation Code does not provide the statutory definitions necessary for interpreting the managing general partner requirement for welfare exemption purposes, we turn to the California Corporations Code for guidance. The California Revised Limited Partnership Act Corp. Code §§15611 et seq., (hereinafter CRLPA), governs limited partnerships, and prescribes the rights, powers, duties and liabilities of limited partners and general partners.

A limited partnership is defined as “a partnership formed by two or more persons under the laws of this state and having one or more general partners and one or more limited partners.” (Corporations Code § 15611, subd. (r).)

Authority for a general partner to manage the business of the limited partnership is found in Corporation Code section 15643, subd. (a), which provides that a general partner of a limited partnership has the same rights, powers, duties and liabilities of a general partner of a general partnership.

Where the CRLPA has no provisions governing a particular subject matter, the provisions of the Uniform Partnership Act (Corporations Code §§ 16100 et seq.) govern limited partnerships. Unfortunately, neither the CRPLA nor the Uniform Partnership Act specifically defines the term, “managing general partner.” However, applying these basic Corporations Code provisions to the requirements of section 214, the legal staff has concluded that the term can reasonably be construed to mean a general partner authorized by the limited partnership agreement to direct, conduct or control the business of the limited partnership. Such a managing general partner of a limited partnership would possess all the statutory powers authorized to a general partner of a general partnership, except those expressly limited or eliminated by the provisions of the limited partnership agreement.

C. The Scope of Management Responsibility of A Managing General Partner

The Assessor’s Handbook, AH 267, *Welfare, Church and Religious Exemptions*, provides broad rather than specific guidance in evaluating the managing general partner’s management responsibilities. The Handbook advises that the limited partnership agreement typically provides a broad delegation of authority to the managing general partner; however, attention should be focused on “which decisions are reserved for the managing general partner, other general partners and the partnership as a whole.” (Assessors’ Handbook, Section 267, page 67). Consistent with this statement in the handbook, the legal staff has opined that the nonprofit managing general partner should have some exclusive, substantial and separate partnership management duties and responsibilities. An exception to this rule is discussed in Part D below, which states that, under certain facts, the Board has found a nonprofit managing general partner qualified when the limited partnership agreement provides for the sharing of management power between two general partners.

The Handbook goes on to say that, “[t]he managing general partner’s responsibilities and duties, as stated in the limited partnership agreement, must reflect that it is, in fact, managing some aspect of the business of the partnership. For example, if the managing general partner’s sole duty is to maintain its status as a tax-exempt nonprofit organization under federal law, (IRC, section 501(c)(3)), the organization does not meet the managing general partner requirement due to an absence of management responsibilities and duties.” (See Handbook, page 67) However, the handbook, like the statutes and the case law, does not state what management duties and responsibilities, at a minimum would be required for a nonprofit corporation to qualify as the managing general partner of a limited partnership.

As noted above, Section 15643, subd. (a) of the Corporations Code provides authority to the general partner to manage the partnership business and to exercise the powers consistent with that authority. As set forth in the CEB Practice Handbook, *Advising California Partnerships*,² those powers may include, subject to the applicable rights of the Limited Partners, the following:

- Acquire, hold, assign or dispose of property or any interest in property
- Borrow money on behalf of the partnership, encumber partnership assets, place title in the name of nominee to obtain financing
- Prepay in whole or in part, refinance, increase, modify or extend any obligation
- Manage the property, rental of units, maintenance and repair
- Retain and supervise property management agent
- Employ at partnership expense, building management agents, other on-site personnel, insurance brokers, loan brokers, real estate brokers, attorneys and accountants
- Pay organizational expenses incurred in the creation of the partnership and all operational expenses
- Sign deeds, notes, deeds of trust, contracts and leases; and other such legal documents that bind the Partnership
- Maintain all partnership books and records
- Open and maintain Partnership bank accounts
- Supervise preparation of all tax returns, budgets and reports, and provide to the limited partners
- Determine the amount and timing of distributions
- Cause the partnership to enter into other partnerships as a general or limited partner and exercise the duties required of the partnership as a partner in any other partnership.

In summary, to be a “managing general partner,” the nonprofit corporation should possess the authority to exercise at least some of the management responsibilities listed above on a day to day basis. As discussed in the next section, that authority may be shared to some extent with other general partners in the limited partnership.

² California Continuing Education of the Bar, Second Edition, §5.104, with 1998 supplement.

D. Shared Management Authority

Corporations Code, section 15645 provides that a limited partnership agreement may create a hierarchy of classes of general partners; with some general partners having more rights, powers, and duties than others. Consistent with these provisions, the Board's position is that a limited partnership may have multiple general partners who may decide among themselves which general partners will have which duties and responsibilities, provided that the nonprofit managing general partner has at least some substantial partnership management duties and responsibilities over some aspect of the partnership business. (See Assessors' Handbook, AH 267, *Welfare Church and Religious Exemptions*).

Some limited partnership agreements authorize a sharing of management duties and responsibilities between the nonprofit managing general partner and another general partner. An example would be language stating that "the general partners acting unanimously within the authority granted to them shall have full, complete and exclusive discretion to manage and control the business of the partnership...and shall make all the decisions affecting the partnership and shall manage and control the partnership." In our view, such provisions requiring each general partner to obtain the consent of the other prior to taking any action or making any decision, provide equal authority to each in managing the business of the partnership. As such, the nonprofit managing general partner would have sufficient management responsibilities and duties to qualify for exemption as a managing general partner within the meaning of section 214, subd. (g).

II. PROVISIONS OF LIMITED PARTNERSHIP AGREEMENTS FOUND TO BE INCONSISTENT WITH THE MANAGING GENERAL PARTNER REQUIREMENT

In reviewing limited partnership agreements with two or more general partners, the legal staff has found that many such agreements, when read as a whole, do not provide sufficient management authority to the nonprofit managing general partner. Typically, such agreements contain statements of broad management authority to be shared by the general partners, followed by language that provides the nonprofit managing general partner with authority to manage the day to day operations of the partnership. Without more, this language would satisfy the requirement in section 214, subd. (g)(1) that an eligible nonprofit corporation function as the managing general partner of the partnership business. However, when the limited partnership agreement is read in its entirety, substantially all the management authority is delegated to another general partner.

We have identified the following examples of provisions of limited partnership agreements, which have caused denial of the exemption due to the nonprofit managing general partner lacking management responsibility.

A. Clause Delegating Authority to an "Administrative General Partner"

The staff has reviewed some agreements in which, after granting broad management authority to the nonprofit managing general partner, the agreements add a provision in which the nonprofit managing general partner delegates its entire management authority to an “administrative general partner.” Such a provision, in effect, nullifies the preceding language granting the nonprofit managing general partner authority to manage the partnership business and causes the partnership not to qualify under section 214, subd. (g)(1).

B. Incentive Management Agreements

The staff has also reviewed and rejected limited partnership agreements which grant substantial management authority to a general partner other than the nonprofit managing partner, pursuant to a separate agreement called an “Incentive Management Agreement.” Pursuant to this agreement, the Administrative General Partner, serving in the capacity of a “Supervisory Management Agent,” is paid a fee to perform specified management services. The language in the limited partnership agreement generally provides a broad delegation of management authority to the general partners, but lacks provisions that grant specific management duties to the nonprofit managing general partner. Thus, the delegation of broad management authority to the nonprofit managing general partner is rendered meaningless by the Incentive Management Agreement that authorizes the Administrative General partner to perform a substantial number of management duties. The nonprofit managing general partner is left without decision-making authority over any aspect of the limited partnership’s operation, causing it not to satisfy the requirement in section 214(g)(1).

C. Diversion of Management Authority from the Nonprofit Managing General Partner to the Other General Partner

Some limited partnership agreements contain a provision that grants broad management authority over the partnership business to the general partners, followed by numerous separate provisions that grant decision-making authority over substantially all the functions of the limited partnership to the general partner other than the nonprofit managing general partner. When this agreement is read as a whole, substantially all the management authority of the limited partnership business has been diverted piecemeal to the other general partner, leaving none for the nonprofit “managing general partner.” As such, the nonprofit managing general partner is not qualified within the meaning of section 214(g)(1) due to insufficient management duties and responsibilities.

D. Management Duties of the Managing General Partner

Staff’s review of numerous limited partnership agreements also has uncovered the problem that such agreements often specify separate “managerial” responsibilities to the Managing

General Partner that, in fact, are not management duties because they do not involve decision-making authority over some aspect of the partnership business. Such responsibilities include advising the general and limited partners about the requirements of low-income families, publicizing the availability of the low income housing, and obtaining information from tenants. While these activities are beneficial to the operation of the low-income housing project, they do not constitute management of the partnership business. In this factual situation, the limited partnership agreement designates virtually all the management authority, function by function, to the other general partner. Absent provisions of the limited partnership agreement that provide decision-making authority to the managing general partner over some aspect of the limited partnership's general operations, the property will not qualify for exemption.

III. EXAMPLES OF AGREEMENTS THAT MEET THE REQUIREMENTS OF THE CODE

We have also been asked to provide examples of limited partnership agreements that we have found meet the requirements of the code. I have attached two examples of such agreements.

If you have any questions about this opinion, please do not hesitate to contact me at 445-4380 or Mary Ann Alonzo at 324-1392.

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Attachment

Cc: Mr. E. L. Sorensen, Jr.
Mr. Larry Augusta
Ms. Mary Ann Alonzo

Examples of Agreements that Meet the Requirements of the Code

Duties of a Managing General Partner under Section 214

The following examples are from limited partnership agreements that, in our opinion, have provided the nonprofit managing general partner with sufficient management duties and responsibilities.

Example No. 1

Section 6.1 Business Management and Control

A. The General Partners shall have the exclusive right to manage the business of the Partnership. No Limited Partner shall have any authority or right to act for or bind the Partnership.

B. The powers and duties of the General Partners shall be exercised by the Managing General Partner, who subject to the terms and provisions of this Agreement, shall direct the business and affairs of the Partnership....

C. The Managing General Partner is hereby designated as the Tax Matters Partner for the Partnership.

Section 6.4 Duties and Obligations of the General Partners

A. The Managing General Partner shall use its best efforts to carry out the purposes, business and objectives of the Partnership, and shall devote to the Partnership business such time and effort as may be necessary to (i) supervise the activities of the Management Agent, (ii) make inspections of the project to determine if the project is being properly maintained and that necessary repairs are being made, (iii) prepare or cause to be prepared all reports of operations which are to be furnished to the Partners by any Lender or Agency, (iv) elect to defer the commencement of the credit period for all or any portion of the low-income housing tax credit allowable to the Partners under Section 42(g) of the Code (v) cause the Project to be insured against fire and other risks covered by such insurance in the maximum amount required by any Lender and/or the Agency, (vi) obtain and keep in force during the term of the Partnership adequate business or rental interruption and workmen's compensation insurance satisfactory to each Lender and the Agency, (vii) enforce all contracts entered into for the benefit of the Partnership, (viii) do all other thing which may be reasonably necessary to manage the affairs and business of the Partnership.

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Example No. 2

Section 7: Management

7.1 Control in the General Partners

Subject to the applicable rights of the Limited Partner specified elsewhere in this Agreement and the limitations on the General Partners' actions contained herein, the General Partners shall have exclusive control over the Partnership's business and shall have all of the rights, powers, and authority generally conferred by law or necessary, or advisable and consistent with, accomplishing the Partnership's purpose. Without limiting the generality of the foregoing, the General Partners shall have the right, subject to the applicable rights of Limited Partner specified elsewhere in this Agreement and the limitations on the General Partners' actions contained herein:

(a) To acquire, hold, sell lease, exchange or convey real and personal property or any interest therein on the Partnership's behalf upon such terms as it deems advisable;

(b) To borrow money on the Partnership's behalf, to mortgage or otherwise encumber Partnership property, upon such terms as it may deem necessary or advisable;

(c) To prepay in whole or in part, refinance, increase, modify or extend any agreement, note, lease, mortgage, deed of trust or other obligation affecting Partnership property;

(d) To delegate duties to and employ from time to time, at the Partnership's expense, any Persons necessary or advisable for the management and operation of the Partnership's business, including property managers, on-site personnel, insurance brokers, leasing agents, real estate consultants, accountants, attorneys, architects and engineers, on terms and for compensation as are reasonable and customary for similar services;

(e) To pay all Partnership expenses;

(f) To negotiate, enter into and execute notes, deeds, deeds of trust, contracts, leases, assignments and other instruments and to take any other actions necessary or desirable on the Partnership's behalf in connection with any of the rights of the General Partners set forth in this section, and

(g) To take any other action incidental to any of the foregoing or consistent with the purposes of the Partnership.

Example No. 2 Continued

7.3 Rights and Duties of the Managing General Partner

The Managing General Partner shall be responsible for the management and control of the affairs of the Partnership, subject to the rights of _____ in its capacity as a General Partner and the Limited Partner. The Managing General Partner's powers and responsibilities shall include the following:

- (i) To perform such tasks as the Managing General Partner determines are necessary or convenient in connection with maintaining and enhancing community support for the Project;
- (ii) To delegate duties to and employ from time to time, at the Partnership's expense, any persons necessary or advisable for the management and operation of the Partnership's business, including, but not limited to, property managers, on-site personnel, insurance brokers, leasing agents, real estate consultants, attorneys, architects and engineers, on terms and for compensation as are reasonable and customary for similar services;
- (iii) To maintain ongoing involvement in the management of the Project as an asset of the Partnership subject to the delegation of the responsibility to the Property Manager;
- (iv) To open and maintain a Partnership bank account or accounts in which all the funds of the Partnership shall be deposited;
- (v) To maintain the books and records of the Partnership;
- (vi) To pay, on behalf of the Partnership, out of Partnership funds, all taxes and governmental charges assessed against, or as a result of the Project and/or the Partnership, and all other reasonable expenses incurred in accordance with this Agreement, as appropriate, in connection with the ownership, maintenance and operation of the Project;
- (vii) To oversee the Partnership's compliance with all regulatory schemes applicable to the Project, including, without limitation, those imposed by Section 42 of the Internal Revenue Code of 1986, as amended.

The limited partnership agreement goes on to say that all the general partners and limited partner must consent as to the sale, lease transfer or mortgage of the Project or assignment of rights in partnership property.